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## CITY OF SAN JOSÉ, CALIFORNIA

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March 12, 1987

Honorable Mayor and Members  
of the City Council  
801 North First Street, Room 600  
San Jose, CA 95110

Transmitted herewith is a report on A Performance Audit of the City Utility Tax Collection Process. This report is in accordance with City Charter Section 805(a).

An Executive Summary is presented on the blue papers in the front of this report while the Administration response (Finance Department) is shown on the yellow pages after the Attachments.

In addition, we have included some comments on the Administration's response. These comments are on the green pages immediately following the Administration's response.

I will present this report to the Finance Committee at its March 18, 1987 meeting. If you need additional information in the interim, please let me know. City Auditor staff who participated in the preparation of this report are Jeffrey Mikles and Rene Bulan.

Respectfully submitted,

Gerald A. Silva  
City Auditor

GS:mlt  
EXSUM018

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**OFFICE OF THE  
CITY AUDITOR**

**A PERFORMANCE AUDIT OF  
THE CITY'S UTILITY TAX COLLECTION PROCESS**

**A REPORT TO THE  
SAN JOSE  
CITY COUNCIL**

**MARCH 1987**

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## EXECUTIVE SUMMARY

In accordance with the City Auditor's approved 1985-86 Workplan, we have completed an audit of the City's utility tax collection process. This is the first report in a series of revenue audits. We examined the process to determine whether the utility companies are collecting the tax effectively and remitting it to the City correctly and promptly. In addition, we evaluated the Finance Department's tax collection monitoring and control process to identify opportunities for improvement.

Our review revealed instances where the City failed to collect utility taxes that were due, allowed invalid utility tax adjustments, or did not collect the required interest charges on late remittances of utility taxes. As a result, we estimate that the City potentially lost approximately \$300,000 during 1985-86.\* Accordingly, the following should be implemented:

- o Finance should improve its monitoring of utility tax receipts to ensure collection of late payment charges.
- o Delays in 1) Finance notifying the utility companies of annexations and 2) the utility companies applying the tax on newly annexed property should be eliminated.
- o Finance should improve its monitoring of the tax adjustment and delinquent tax collection processes.
- o Finance should improve its controls over the utility tax exemption process.

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\*Of the \$300,000 in potential losses, \$112,300 was for the period February 1985 through May 1986.

*Finance Should Improve Its Monitoring  
of Utility Tax Receipts to Ensure  
Collection of Late Payment Charges*

Due to insufficient monitoring of tax receipts, Finance has failed to collect interest and penalties on late tax payments. During 1985-86 we noted instances where utility companies were late in remitting their tax payments. However, Finance did not 1) impose ordinance required interest, or 2) send out late notices. As a result, the City may have lost as much as \$64,800 in late payment interest charges and penalties during 1985-86. Further, the Municipal Code needs to be amended to clearly define when the City should receive tax payments. By amending the Code to require that the City receive tax payments by the end of the month, Finance would save staff time and expenses, and the City would earn additional interest income.

*Delays in 1) Finance Notifying the  
Utility Companies of Annexations,  
and 2) the Utility Companies Applying  
the Tax on Newly Annexed Property  
Should be Eliminated*

Due to the lack of 1) established time standards, 2) clearly defined responsibilities, and 3) adequate monitoring, Finance has been late in notifying the utility companies of new property annexations and the utility companies have been late in applying the tax. Consequently, from February 1985 through May 1986, the City lost an estimated \$112,300 in utility taxes due to compounded delays in charging the tax on new annexations.

Finance Should Improve Its Monitoring of the  
Tax Adjustment and Delinquent Tax Collection Processes

The Finance Department has not effectively monitored utility company tax adjustments or attempted to collect delinquent taxes from utility users. The Department allows three of the four major utility companies to make unsubstantiated and unverifiable tax adjustments. In addition, while Finance attempts to collect from utility users who refuse to pay the tax, it does not attempt to collect those delinquent taxes that utility companies turn over to the City for collection. As a result, during 1985-86 the City allowed over \$15,900 in invalid tax adjustments and did not pursue collection of \$100,988 in delinquent utility taxes.

Finance Should Improve Its Controls Over  
the Utility Tax Exemption Process

The Finance Department is not determining which utility users are exempt from paying the utility users taxes despite a City regulation requirement to do so. Further, the Department 1) allows the utility companies to determine exemption eligibility, 2) does not require any documentation to support the utilities' decisions, and 3) with one exception, does not have current listings of utility users who are being exempted from paying utility taxes. As a result, during 1985-86, Finance did not collect at least \$8,500 in utility users taxes it should have.

## RECOMMENDATIONS

We recommend that the Finance Department:

### Recommendation #1:

Recommend to the City Council that the Municipal Code be amended to 1) specify that the City is to receive utility tax payments by the end of the month or June 25 in the case of May collections, and 2) automatically impose penalties on late payments. (Priority 1)

### Recommendation #2:

Advise all the utility companies of the Municipal Code penalty and interest provisions with respect to late payments and inform them of the City's intention to apply the penalty and interest charges accordingly. (Priority 1)

In addition, we recommend that the City Manager:

### Recommendation #3:

Define the responsibilities and time standards involved in preparing the San Jose Street Index revisions and correction letters, formally assign the responsibilities to the proper department, and provide the required resources to ensure that the responsibilities are carried out effectively and efficiently. (Priority 1)



It is further recommended that the Finance Department:

Recommendation #4:

Recommend to the City Council that the Utility Users Tax Ordinance be amended to specify how many days after City notification of annexations the utility companies have to apply utility taxes on customer billings. (Priority 1)

Recommendation #5:

Establish a monitoring procedure to ensure that the utility tax on newly annexed addresses are promptly included on the customer's utility bills. (Priority 1)

Recommendation #6:

Amend the City's utility tax remittance regulations to be in consonance with the current Municipal Code and require utility service providers to remit utility taxes on the basis of collections, not billings. (Priority 2)

Recommendation #7:

Initiate the collection of City Auditor identified invalid or overstated tax adjustments. In addition, Finance should 1) require utility companies to provide sufficiently detailed tax adjustment reports to allow for subsequent review, and 2) review on a sample basis reported tax adjustments for propriety. (Priority 1)

Recommendation #8:

Initiate the collection of those tax accounts the utilities turned over to the City as provided for in Section 4.68.150(B). (Priority 1)

Recommendation #9:

Update the utility users tax regulations adopted in August, 1970, and provide all utility companies with copies, including excerpts, of San Jose Municipal Code Chapter 4.68 (the Utility Tax Ordinance). (Priority 2)

Recommendation #10:

In conjunction with the utility companies, develop and document a tax exemption process to ensure City control over eligibility determination and the efficient and timely processing of tax exemption applications. (Priority 1)

Recommendation #11:

Develop a tax exemption application form for those utility users requesting exemption from the utility users tax. Finance should use and retain copies of the form to document:

- The basis for granting exemptions to claimants;
- The extent of verification performed on the claimant's representations; and
- Who reviewed and approved the exemption.  
(Priority 2)

Recommendation #12:

Require the utility companies to submit customer exemption lists to the City at least quarterly, including any partial lists available from the telephone companies. Finance should review these lists to ensure that all customers are eligible for the tax exemption. (Priority 2)

## INTRODUCTION

The City Finance Department administers the utility users tax (tax) collection process. As a result of Ordinance 15285, the tax was levied and took effect on September 1, 1970. The City Council passed this revenue measure to avoid an expected revenue shortfall of \$5 million in fiscal year 1970-71. Without such a measure, the City faced an estimated 9.6% reduction in services and a corresponding reduction in the City's work force.

### The Ordinance

Specifically, the ordinance specifies that a 7-1/2 % tax rate was to be applied to each user's utility bills (electricity, gas, telephone and water) from the first billing period on or after September 1, 1970 until the last billing period on or before April 30, 1971. Beginning May 1, 1971, the tax rate dropped to its current 5% level. In addition, the ordinance exempts certain utility service users from the tax. These include the following:

- City government;
- State government and its political subdivisions including counties, cities, districts and other public agencies;
- Federal government and its public agencies;
- Insurance companies and their agents.

In addition, electrical, gas, telephone, and water corporations are exempted from taxes on the use of their own utility service.

Utility Users Tax Revenues

Over the past six fiscal years, the utility tax has consistently ranked as the General Fund's third largest revenue source, after sales and property taxes. Table I below shows the tax's increasing revenue trend for 1980-81 through 1985-86:

TABLE I  
UTILITY TAX REVENUE FOR FISCAL YEARS  
1980-81 THROUGH 1985-86

<u>Fiscal Year</u>	<u>Revenue</u>
1985-86	\$31,827,200
1984-85	29,496,400
1983-84	24,133,500
1982-83	23,877,600
1981-82	23,448,900
1980-81	18,293,000

The ordinance specifies that utility service providers shall collect the tax at the same time as and along with their regular billing. There are 20 utility companies and agencies that collect the tax, but four large concerns collect approximately 96% of the annual tax revenue. Table II summarizes the 1985-86 revenue distribution:

TABLE II

PERCENTAGE OF UTILITY TAX REVENUES  
BY COLLECTING ENTITY FOR 1985-86

<u>Collecting Entity</u>	<u>Revenue Share</u>	
Pacific Gas & Electric (PG&E)	64.7%	
Pacific Bell	19.0	
San Jose Water Co.	6.6	
AT&T Communications	5.6	
Subtotal	95.9%	95.9%
12 Other Telephone Companies	2.5%	
San Jose Municipal Water System	0.8	
Two Other Water Companies	0.5	
City/County of San Francisco	0.3	
Subtotal	4.1%	4.1
Total		<u>100.0%</u>

The Remittance Process

Each utility collecting entity remits the tax to the City Finance Department, Treasury Division, Accounts Receivable Section on a monthly basis. The utility tax regulations give the utility companies the option of basing tax remittances on monthly customer billings or taxes collected monthly by the utility. The four major utility companies have opted to base their remittances on monthly customer billings.\*

The Accounts Receivable Section is responsible for administering the tax collection process. The section is staffed with eight employees: three investigator-collectors,

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\*The Utility Tax Ordinance requires that utility tax remittances are to be based on collections and does not provide for utility tax remittances to be based on billings. (See page 21 for a discussion of this issue).

four account clerks, and one clerk-typist. In addition to collecting the utility users tax, the section collects the conveyance and transient occupancy taxes. The bulk of the section's activities is spent in collecting damage billings from the public. It also collects funds on all other City-generated charges and selected franchise fees. The section's budget for 1986-87 is \$273,800.

#### Audit Objectives and Scope

The audit objectives were to determine 1) if the utility companies are effectively collecting the utility tax from their customers, and 2) whether the City is receiving the tax in a correct and timely manner. We also attempted to determine how effectively and efficiently the Finance Department is administering the claimant exemption process, monitoring tax and late penalty collection, and verifying tax adjustment validity and accuracy.

Initially, we intended to focus our review on the tax collections of the four major utility companies since they accounted for about 96% of the tax revenue in 1985-86. However, due to Public Utility Commission restrictions regarding the release of customer information, we were unable to test Pacific Bell and AT&T tax collections. Consequently, we were limited to testing PG&E and San Jose Water Company records, which together accounted for approximately 71% of the total tax collected in the fiscal year. As a result, our sampling scope was restricted, but the evidence presented indicates that opportunities exist to improve the systemic deficiencies identified in this report.

## *FINDING I*

### *FINANCE NEEDS TO IMPROVE ITS MONITORING OF UTILITY TAX RECEIPTS TO ENSURE COLLECTION OF LATE PAYMENT CHARGES*

Due to insufficient monitoring of tax receipts, Finance has failed to collect interest and penalties on late tax payments. During 1985-86 we noted instances where utility companies were late in remitting their tax payments. However, Finance did not 1) impose ordinance required interest, or 2) send out late notices. As a result, the City may have lost as much as \$64,800 in late payment interest charges and penalties during 1985-86. Further, the Municipal Code needs to be amended to clearly define when the City should receive tax payments. By amending the Code to require that the City receive tax payments by the end of the month, Finance would save staff time and expenses, and the City would earn additional interest income.

#### *Municipal Code Requirements*

The Municipal Code 1) specifies when utility taxes will be remitted, and 2) imposes interest charges and provides for penalties on late tax payments. Sections 4.68.050(D), 4.68.060(D), 4.68.070(C), and 4.68.080(B) require electricity, gas, telephone and water service providers to collect the current month's tax and remit it to the City on or before the last calendar day of the following month, except that taxes collected in May of any year must be remitted on or before



June 25. Code Section 4.68.130(B) provides that Finance shall impose on a service provider a ten percent penalty on overdue taxes that are not remitted within ten days after receipt of the City's late notice. Further, any service provider who fails to remit any tax shall pay interest at the rate of one-half of one percent per month on the tax amount, exclusive of penalties, from the first delinquency date until paid.

#### Late Tax Remittances

Our review of the 1985-86 utility tax remittances revealed that the City did not receive tax payments by the date specified in the above ordinances from 13 of 18 companies (72%) about 49 percent of the time. The City received tax payments of \$66 to \$1,983,200 from one to 101 days after the ordinance specified date. However, at no time during 1985-86 did Finance impose ordinance required interest charges. Further, Finance did not send out the late notices provided for in Code Section 4.68.130(B). Consequently, Finance could not apply late payment penalties. Based on the Municipal Code interest and penalty provisions, we estimate that Finance may have been able to collect approximately \$61,900 in interest charges and \$2,900 in penalties as shown in Appendix A.

It should be noted that according to Finance Officials, it was and is the Department's policy to accept as current any utility tax payments that are postmarked by the ordinance specified date. Accordingly, such a policy requires someone in Finance to inspect postmark dates on tax payments to determine payment timeliness.

Further, under that policy, those payments in Appendix A that were received three days or less after the ordinance specified date should probably not be considered late. Thus, Finance's ordinance interpretation would reduce our estimate of the interest charges Finance did not impose on late tax payments. For example, eliminating those payments that were received three days or less after the ordinance date would reduce our estimate of lost interest charges from \$61,888 to \$15,383.

It should also be noted, however, that Finance's interpretation of the Municipal Code is not documented in any sort of procedure manual or memorandum. Further, the Department's failure to impose interest charges or late penalties on obviously late tax payments clearly indicates that the Department did not in fact examine postmarks on tax payments as a means of determining payment timeliness.

Finally, based on discussions with Finance and the City Attorney's Office, it appears that the Municipal Code should be amended to more clearly define when utility suppliers are required to make payments to the City. As it is currently written, the Code is ambiguous as to whether 1) suppliers should mail tax payments, or 2) the City should receive tax payments by the last day of the month.

According to Finance, one consequence of the Code's ambiguity is that someone from the Department currently drives to San Francisco each month to collect PG&E's monthly tax payment. This trip is necessary to insure that the City receives PG&E's payment\* by the last day of the month. Should the Municipal Code be amended to require that the City receive utility tax payments by the end of the month then 1) Finance's monthly trips to San Francisco would no longer be necessary, and 2) the City would, on the average, collect utility taxes several days sooner than it currently does. As a result, Finance would save staff time and expenses and the City would be able to earn additional interest from earlier collection of taxes.

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\*PG&E's payment represents about 65 percent of total utility taxes.

## CONCLUSION

Our review of 1985-86 utility tax remittances showed that the City received tax payments from 72 percent of the utility companies after the date specified in the Municipal Code. If the Finance Department had effectively monitored the remittances, sent out the required late notices, and enforced the Municipal Code delinquency provisions, the City may have collected as much as \$64,800 in interest and penalty charges during 1985-86. Further, the Municipal Code needs to be amended to clearly define when the City should receive tax payments. By amending the Code to require that the City receive tax payment by the end of the month, Finance would save staff time and expenses and the City would earn additional interest income.

## RECOMMENDATIONS

We recommend that the Finance Department:

### Recommendation #1:

Recommend to the City Council that the Municipal Code be amended to 1) specify that the City is to receive utility tax payments by the end of the month or June 25 in the case of May collections, and 2) automatically impose penalties on late payments. (Priority 1)

Recommendation #2:

Advise all the utility companies of the Municipal Code penalty and interest provisions with respect to late payments and inform them of the City's intention to apply the penalty and interest charges accordingly. (Priority 1)

## FINDING II

### DELAYS IN 1) FINANCE NOTIFYING THE UTILITY COMPANIES OF ANNEXATIONS, AND 2) THE UTILITY COMPANIES APPLYING THE TAX ON NEWLY ANNEXED PROPERTY SHOULD BE ELIMINATED

Due to the lack of 1) established time standards, 2) clearly defined responsibilities, and 3) adequate monitoring, Finance has been late in notifying the utility companies of new property annexations and the utility companies have been late in applying the tax. Consequently, from February 1985 through May 1986 the City lost an estimated \$112,300 utility taxes due to compounded delays in charging the tax on new annexations.

#### Code Requirements

The Municipal Code is silent on the issue of time standards for the City notifying utility companies of newly annexed property and when utility companies should apply utility taxes on customers' billings. Consequently, Finance lacks specific guidelines for advising the utilities of such annexations or monitoring the timeliness of the tax application process.

#### Annexation Update Process

When the City annexes a new land tract, the Finance Department inspects the area to identify the streets,

residential and business addresses, and improvements that exist within the tract. Based on the inspection, Finance issues a Street Index Correction Letter and updated pages of the San Jose Street Index. The Street Index is an alphabetical listing of street names and address numbers within the City's legal boundaries. Finance issues the correction letter and updated Street Index pages to City, County, and State agencies; sanitation districts; and utility companies.

Recipients of the correction letters and updates use the Street Index as their basis for determining the application of various taxes, licenses and fees. For example, in applying the utility tax on newly annexed property, the utility companies rely on the data to inform them which addresses should be taxed and when. The utility companies normally begin accruing the tax at the start of the billing period immediately following the company's receipt of the correction letter. Accordingly, if Finance delays issuing the correction letters and updates, or if the utility fails to apply the tax in a timely manner, the City loses revenue in the form of forgone taxes.

#### Estimated Tax Loss

During the period from February 1985 through May 1986, the City annexed 81 land tracts with 3,910 taxable units or addresses. To assess the minimum estimated tax loss for these tracts, we initially reviewed all the annexation files and

computed the time differences between the annexation effective dates and the dates Finance issued the correction letters. We also computed the time differences between the correction letter issue dates and the effective dates the utility companies began accruing taxes on 15 selected addresses. To obtain a representative sample, we extracted the 15 addresses from three large annexations containing over 1,100 taxable addresses, or 28 percent of the newly taxable addresses.

Our review revealed that Finance issued the correction letters to the utility companies and other agencies on the average of 21 days after the annexation date. This is based on a turnaround time ranging from two to 147 days after the annexation dates. However, the utility companies did not perform as well in applying the tax. Our review of the sample 15 taxable addresses indicates that the utility companies took an average of 106 days to begin charging the tax after the correction letters were sent. Observed delays ranged from 27 to 324 days.

To further estimate the minimum tax loss, we calculated the average daily tax rate for each address based on the tax payments of the 15 sample addresses. We also developed an average delay rate per address and, with the average tax rate, projected these to the three large annexations containing 1,110 addresses. Table III displays the estimated tax loss from both City and company-induced delays:



TABLE III

ESTIMATED UTILITY TAX LOSS ON 1,110  
ANNEXED ADDRESSES DUE TO CITY AND COMPANY DELAYS

<u>Annexation Name</u>	<u>Tax Loss from Delays by:</u>		
	<u>City</u>	<u>Company</u>	<u>Total</u>
Story 36 (367 addresses)			
Elect./Gas	\$ 5,395	\$ 2,202	\$ 7,597
Water	4,316	1,145	5,461
Telephone	2,098	1,812	3,910
Franklin 38 (317 addresses)			
Elect./Gas	1,575	599	2,174
Water	450	184	634
Telephone	875	2,748	3,623
Maypark 18 (426 addresses)			
Elect./Gas	920	16,563	17,483
Water	153	358	511
Telephone	<u>298</u>	<u>1,789</u>	<u>2,087</u>
Total	<u>\$16,080</u>	<u>\$27,400</u>	<u>\$43,480</u>

The above table shows a \$43,500 estimated tax loss on the 1,110 taxable addresses included in our sample. In addition, assuming our sample was representative of the remaining 2,800 addresses, we project an additional \$68,800 estimated tax loss. Therefore, the total estimated tax loss due to City and company delays would be \$112,300 for the 3,910 addresses annexed during the 16-month period.

For purposes of developing the above estimates, we assumed that all elapsed time after the effective dates of annexation were incurred delays. It may be reasonable, however, to allow the City and the utility companies a certain amount of time to process a tax status change on an annexed property. Depending on any grace period allowed, the above estimates may be reduced correspondingly.

However, it should be noted that Finance does not initiate its inspection process until the City Clerk notifies it of an annexation. Further, our review of the annexation process revealed that the Planning Department sends Finance copies of boundary maps for property to be annexed as much as 12 weeks before Finance is currently starting its inspection process. Further, the City Council approves annexations two to three weeks before they are effective. Thus, in our opinion, Finance should be able to have its inspection process either completed or substantially completed by the time annexations are effective.

#### Delays in Notifying Utilities

We interviewed Treasury Division personnel to determine the cause of delays in notifying utility companies of newly annexed property. They stated that the San Jose Street Index was originally compiled for internal use only by the Division's Sewer Service Section. Over the years, the street index has proven to be the most comprehensive list of its kind in the City and has been given general distribution.

However, the Sewer Service Section does not claim that the index is accurate nor has the Section been mandated the specific responsibility or resources necessary to maintain an official city street index. In fact, the Section attaches a disclaimer to each correction letter released which states that the index is provided solely as a courtesy and that no warranties of any nature are made

as to the accuracy of the information. Further, because the Section has other defined and sometimes more pressing responsibilities, its staff is not always able to update the index on a current basis. Consequently, the information may not always be accurate or revised and released in a timely manner.

In addition, we were advised that several other City departments are currently undertaking expanded versions of the street index. We did not review these projects to determine the extent that they may duplicate or replace the index the Section maintains. However, in our opinion, the responsibility for maintaining an accurate and timely street index needs to be clearly defined and formally assigned to the most appropriate department.

#### Delays in Charging Tax

Based on discussions with utility company personnel, it appears that their delays in charging the tax are related to their inability to monitor and process a tax status change on newly annexed property in a timely manner. In the case of one major telephone company, we were told that the company's internal procedures require at least two and one-half months to process such tax changes. To provide for a quicker change of status, the company advised us that it may have to revise its data processing programs and procedures and charge the City the resulting costs. Another utility company informed audit staff that the utility tax

still had not been applied nearly one year after the City sent out its notification letter. According to the utility company, it never received the City's notification letter. Instances such as these clearly demonstrate the need for 1) ordinance specificity regarding the timeliness of utility company application of utility taxes on annexed property, and 2) Finance to monitor how quickly the utility companies are applying the tax.

#### CONCLUSION

Our review of the utility tax application process for newly annexed property disclosed that the City has been late in notifying the utility companies of new taxable addresses and the utilities have been late in charging the tax on their utility bills. Consequently, such delays have resulted in an estimated tax loss to the City of \$112,300 for annexations processed during a 16-month period ending May 31, 1986.

Historically, the Finance Department has notified the utility companies of newly annexed addresses through street index correction letters and street index revisions prepared by its Sewer Service Section. However, this Section has not always been able to update the index on a current basis. Further, there are currently other projects underway in other departments to construct a street index which may result in a duplication of effort. Therefore, it

is important that 1) the responsibility for preparing and revising the street index be assigned to the appropriate department, and 2) reasonable time standards be developed for updating and releasing street index information.

Finally, the utility companies have also caused significant delays in new taxpayer billings. These delays occur because companies are not able or reluctant to promptly change the tax status of newly annexed addresses and the City has no established time standards which require utility companies to do so within a specified time period. Accordingly, the City should establish an appropriate time standard and utility companies need to develop the capability to change the tax status quickly.

#### RECOMMENDATIONS

We recommend that the City Manager:

##### Recommendation #3:

Define the responsibilities and time standards involved in preparing the San Jose Street Index revisions and correction letters, formally assign the responsibilities to the proper department, and provide the required resources to ensure that the responsibilities are carried out effectively and efficiently.  
(Priority 1)

It is further recommended that the Finance Department:

Recommendation #4:

Recommend to the City Council that the Utility Users Tax Ordinance be amended to specify how many days after City notification of annexations the utility companies have to apply utility taxes on customer billings. (Priority 1)

Recommendation #5

Establish a monitoring procedure to ensure that the utility tax on newly annexed addresses are promptly included on the customer's utility bills. (Priority 1)

### FINDING III

#### FINANCE SHOULD IMPROVE ITS MONITORING OF THE DELINQUENT TAX COLLECTION PROCESSES

The Finance Department has not effectively monitored utility company tax adjustments or attempted to collect delinquent taxes from utility users. The Department allows three of the four major utility companies to make unsubstantiated and unverifiable tax adjustments. In addition, while Finance attempts to collect from utility users who refuse to pay the tax, it does not attempt to collect those delinquent taxes that utility companies turn over to the City for collection. As a result, during 1985-86 the City allowed over \$15,900 in invalid tax adjustments and did not pursue collection of \$100,988 in delinquent utility taxes.

#### Utility Reporting Requirements

Municipal Code Sections 4.68.050(D), 4.68.060(D), 4.68.070(C), and 4.68.080(B) specify the manner in which utility providers are to remit utility taxes for electricity, gas, telephone, and water, respectively, to the City. In each case, the tax remitted is to be based on the amount of tax "collected." For example, Code Section 4.68.060(D) states:

*"The tax imposed in this section shall be collected from the service user by the person selling the gas. The amount collected in one calendar month shall be remitted to the director of finance of City on or before the last calendar day of the following calendar month, except that the taxes collected in May of any year shall be remitted on or before June 25th. (Emphasis added...)"*

The City's utility users tax regulations, however, differ from the Municipal Code in that the regulations permit utilities to base tax payments on either monthly billings or collections.

#### Tax Revenue and Adjustments

Because the City's regulations allow utility companies to base their tax remittances on customer billings and not just on collections, a relatively complicated monthly adjustment process has evolved to reconcile the differences between remittances based upon monthly billings and subsequent collections. For example, a utility bills a customer \$100. When the utility makes a tax remittance to the City, it includes the \$5 attributable to this particular customer ( $\$100 \times 5\% = \$5$ ). Should the customer pay the utility bill, no adjustment to subsequent monthly remittances is necessary. However, should the customer not pay the bill, then the utility company deducts the \$5 in taxes attributable to this customer from a subsequent remittance.



The preceding example is intentionally simplistic and is designed to be illustrative only. In actual practice, at least one utility makes monthly remittance adjustments involving literally thousands of customer billings each year.

In order to effectuate the remitting of utility taxes based on monthly billings, Finance requires utility providers to submit a monthly tax return which shows gross billings, charges to exempt accounts, taxable charges, tax due (5% of charges), adjustments, plus any penalties and interest. (See Appendix B for a sample return). All four of the major utility providers remit their taxes based upon monthly billings and file the required tax return. However, only one of these providers (PG&E) provides the information required on the tax return in sufficient detail to allow Finance to review the submitted information for appropriate action. Table IV summarizes the tax return information the four utility providers submitted during 1985-1986.

TABLE IV  
SUMMARY OF TAX RETURN INFORMATION  
SUBMITTED BY THE FOUR MAJOR  
UTILITY PROVIDERS DURING 1985-86

<u>Tax Return Information</u>	<u>PG&amp;E</u>	<u>San Jose Water</u>	<u>Pacific Bell</u>	<u>AT&amp;T</u>
Gross Billings	\$448,803,972	\$44,405,541	\$ *	\$ *
Less Exempt Accounts	38,965,520	3,054,197	*	*
Taxable Charges	409,838,452	41,351,344	118,938,004	*
Tax Due - 5%	20,491,923	2,067,567	5,946,900	*
Adjustments:				
Tax Adjustments	176,817**	*	*	*
Customer Refusal to Pay Tax***	358	67	17	8
Tax on Accounts Turned Over to Collection Agencies	88,404	*	*	*
Tax on Accounts Written Off	<u>12,584</u>	<u>*</u>	<u>*</u>	<u>*</u>
Total Adjustments	<u>278,163</u>	<u>7,155****</u>	<u>17</u>	<u>8</u>
Net Tax Payable	<u>\$ 20,213,760</u>	<u>\$2,060,412</u>	<u>\$5,946,883</u>	<u>\$1,760,631</u>

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\*No information submitted by utility provider.

\*\*Includes taxes attributable to customer refunds.

\*\*\*This category is for those customers who pay their utility bills but refuse to pay the City's utility tax portion of the bills.

\*\*\*\*Details were not provided as to the composition of any adjustments.

As shown in Table IV, while all four utility companies are reporting customer refusals to pay the tax, only PG&E reports their other tax adjustments in sufficient detail to permit an in-depth review. However, it should be noted that Finance does not review PG&E's reports or verify the individual accounts contained therein even on a sampling basis. Further, we could find no evidence that Finance has requested or received similar detailed information from the other three utility companies.

#### Lack of Finance Follow-Up On Reported Tax Adjustments

From July 1985 through February 1986, PG&E reported 18,369 tax adjustments with a total value of \$238,055. We examined a judgmental sample of 68 of these tax adjustments totaling \$96,473 for validity and accuracy. Our sample included the largest deductions made during that period. We discovered that nine of the 68 adjustments tested contained either invalid deductions or overstated deductions totaling in excess of \$15,900.

### Collection of Delinquent Taxes

Our review of the other PG&E adjustments revealed that despite a City ordinance requirement to do so Finance has made no attempt to institute any collection action on:

- \$88,404 in taxes attributable to accounts PG&E had turned over to a collection agency and
- \$12,584 in taxes attributable to accounts PG&E had written off.

Municipal Code Section 4.68.150(A) states:

*"Whenever the director of Finance of the City determines that a service user has deliberately withheld the amount of any tax imposed on him by the provisions of this chapter from the amounts remitted to a service supplier required to collect the tax, or whenever the director of Finance deems it in the best interest of the City, he may, but shall under no circumstances be required to relieve such service supplier of the obligation to collect taxes due under this chapter from certain named service users for specified billing periods; provided, that if a service user has failed to pay the amount of the tax to such service supplier for a period of four consecutive billing periods, the director of finance shall relieve such service supplier of the obligation to collect taxes due under this chapter from those named service users for specified billing periods." (Emphasis added...)*

Accordingly, if a utility customer fails to pay utility taxes for four consecutive billings periods, the Director of Finance is responsible for collecting any taxes due. During 1985-86, PG&E reported to Finance that it was reducing its remittance to the City for the tax portion of those customer accounts it was 1) turning over to a collection agency and 2) writing off as being uncollectable. The theory being that because PG&E had previously paid the City for the tax on these accounts when they were originally billed, it was appropriate for PG&E to reduce its remittance to the City to the extent these accounts have proven to be delinquent. In other words, while PG&E was pursuing the collection of the service charge portion of the utility bills it was up to Finance to collect the tax portion. This practice seems to be in keeping with the Municipal Code.

Finance has not, however, pursued any collection effort for the taxes due on those accounts PG&E has turned over to the City. According to PG&E reports for 1985-86, it turned over to the City for collection \$88,404 in taxes on delinquent accounts. Our analysis of the accounts PG&E turned over to the City in 1985-86 revealed the following:

*ANALYSIS OF THE DELINQUENT  
ACCOUNTS PG&E TURNED OVER  
TO THE CITY FOR COLLECTION IN 1985-86*

<u>Amount of Taxes Due</u>	<u>Number of Accounts</u>	<u>Amount</u>
More than \$100	15	\$ 2,936
\$51 to \$100	54	3,560
\$20 to \$50	779	22,117
Less than \$20	<u>11,086</u>	<u>59,791</u>
Totals	<u>11,934</u>	<u>\$88,404</u>

As shown above, \$28,613 of the \$88,404 in delinquent accounts PG&E turned over to the City for collection are for amounts of \$20 or more. According to Finance, it is not cost effective for the City to attempt to collect the above delinquent tax accounts. However, the Municipal Code clearly requires the Director of Finance to attempt to collect all delinquent tax accounts regardless of amount. Specifically, Section 4.68.150(B) states in part:

*"The director of finance shall notify the service user that he has assumed responsibility to collect the taxes due for the stated periods, and demand payment of such taxes. The notice shall be served on the service user by ... deposit of the notice in the United States mail, postage prepaid thereon, ... "*

Further, the Code provides that a minimum \$10 penalty shall be imposed on those delinquent tax accounts that are not paid within 15 days of City notification.

*"... If a service user fails to remit the tax to the finance director within fifteen days from the date of the service of the notice upon him, ... a penalty of ten percent of the amount of the tax set forth in the notice shall be imposed, but not less than ten dollars, and shall become part of the tax herein required to be paid."*  
(Emphasis added ...)

With regard to the above penalty provision, two points are pertinent. First, the penalty cannot be imposed unless Finance notifies the service user of the tax due. Second, the \$10 minimum penalty, by definition, enhances the cost effectiveness of the City's collection effort, especially for small dollar delinquent tax accounts.

Our review of the same PG&E reports also disclosed that PG&E turned over to the City for collection \$12,584 in taxes on accounts the utility had written off. Of that amount, a significant portion was for a relatively few private companies which had filed for bankruptcy. Finance made no attempt to collect the taxes due either directly or indirectly through collection agencies even though claims for unpaid taxes normally are given a high priority for payment when the affairs of a bankrupt company are settled.

It should be noted that Finance does monitor and pursue the collection of taxes due from customers who refuse to pay the tax.\* While such diligence is commendable, it is also ironic because Finance is in effect pursuing the collection of taxes that are insignificant compared to the taxes it is not pursuing. For example, in 1985-86, PG&E reported to Finance only \$358 in taxes due from customers who refused to pay the tax while the total taxes due from delinquent customers was \$100,988. Thus, while Finance did attempt to collect the \$358, it took no action to collect the \$100,988.

In our opinion, Finance should institute collection actions in accordance with Municipal Code Section 4.68.150(B). In addition, Finance should attempt to get from the other large utility companies sufficiently detailed information to allow for adequate follow-up including the institution of collection efforts.

#### CONCLUSION

The Finance Department needs to improve its tax adjustment monitoring process and pursue collection of delinquent utility taxes. The Department does not receive detailed tax adjustment reports from all the utility companies or review or

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\*These customers pay the service portion of their utility bill but for philosophical reasons refuse to pay the tax portion.



verify data for those reports it does receive. Further, Finance has not initiated efforts to collect delinquent taxes although it is required to do so. As a result, in 1985-86, the City allowed approximately \$15,900 in invalid tax adjustments and did not pursue collection of \$100,988 in delinquent utility taxes.

#### RECOMMENDATIONS

We recommend that the Finance Department:

##### Recommendation #6:

Amend the City's utility tax remittance regulations to be in consonance with the current Municipal Code and require utility service providers to remit utility taxes on the basis of collections, not billings. (Priority 2)

##### Recommendation #7:

Initiate the collection of City Auditor identified invalid or overstated tax adjustments. In addition, Finance should 1) require utility companies to provide sufficiently detailed tax adjustment reports to allow for subsequent review, and 2) review on a sample basis reported tax adjustments for propriety. (Priority 1)

##### Recommendation #8:

Initiate the collection of those tax accounts the utilities turned over to the City as provided for in Section 4.68.150(B). (Priority 1)

#### *FINDING IV*

##### *FINANCE SHOULD IMPROVE ITS CONTROLS OVER THE UTILITY TAX EXEMPTION PROCESS*

The Finance Department is not determining which utility users are exempt from paying utility users taxes despite a City regulation requirement to do so. The Department 1) allows the utility companies to determine exemption eligibility, 2) does not require any documentation to support the utilities' decisions, and 3) with one exception, does not have current listings of utility users who are being exempted from paying utility taxes. As a result, during 1985-86, Finance did not collect at least \$8,500 in utility users taxes it should have.

##### *Tax Regulations*

The utility users tax regulations adopted in August 1970 specify that the City Tax Administrator (the Director of Finance) will control tax exemptions through a written application process and will forward the approved applications to the utility companies for appropriate action. In addition, the regulations state that the utility companies shall furnish listings of exempt accounts at the Tax Administrator's request.

### Lack of Controls

Finance has not instituted formal tax exemption application or customer exemption verification processes. At present, a utility customer may request service and a tax exemption directly from the service provider. Since Finance has no involvement in the exemption process, the utility company must determine their customer's tax exemption eligibility. Thus, Finance has relinquished its exemption determination authority to the utility companies.

Further, in almost all cases, Finance has no information or documentation to support the exemptions granted to customers nor has the Department requested exemption lists from the utility companies. Of the four major utility companies remitting taxes, only PG&E has been submitting exempt customer lists and this has been on a voluntary basis. We could find no evidence that the City has ever formally requested such information from any of the other utility companies. As a result, the City has no procedures in place to ensure that only eligible users are being exempted.

We conducted two tests to evaluate the utility companies' determinations of exempt utility users. In the first test, we reviewed for propriety a PG&E quarterly exemption list and an exemption list requested from the San Jose Water Company. As

noted earlier, the Ordinance generally exempts from taxation public sector entities, insurance companies, and utility corporations. Based on the ordinance criteria, we determined that 68 water accounts and 5 PG&E accounts (3,817 total accounts) were ineligible for the tax exemption. We estimated an \$8,500 tax loss as shown in Table V below.

TABLE V

SUMMARY OF THE RESULTS OF  
REVIEW OF EXEMPTION LISTINGS

<u>Utility Company</u>	<u>Number of Exempt Accounts</u>		<u>Estimated Tax Loss</u>
	<u>Reviewed</u>	<u>Ineligible</u>	
San Jose Water Company	1,337	68	\$7,700
PG&E	<u>2,480</u>	<u>5</u>	<u>800</u>
Totals	<u>3,817</u>	<u>73</u>	<u>\$8,500</u>

In a further test, we compared 25 of the exempt San Jose Water Company accounts that we determined should not be exempt against the telephone company's exemptions. For all 25 of the accounts tested, the telephone company did not exempt the users from paying utility taxes. In our opinion, the results of our review demonstrate the need for Finance to make eligibility determinations as the City ordinance requires.

## CONCLUSION

The Finance Department needs to improve its controls over the utility user tax exemption process. Finance has neither approved formal applications for tax exemption nor reviewed utility company determinations of tax exemption. As a result, Finance has relinquished its exemption granting authority to the utility companies and they have granted some exemptions in error. These errors cost the City at least \$8,500 in lost utility taxes during 1985-86.

## RECOMMENDATIONS

We recommend that the Finance Department:

### Recommendation #9:

Update the utility users tax regulations adopted in August, 1970, and provide all utility companies with copies, including excerpts, of San Jose Municipal Code Chapter 4.68 (the Utility Tax Ordinance). (Priority 2)

Recommendation #10:

In conjunction with the utility companies, develop and document a tax exemption process to ensure City control over eligibility determination and the efficient and timely processing of tax exemption applications. (Priority 1)

Recommendation #11:

Develop a tax exemption application form for those utility users requesting exemption from the utility users tax. Finance should use and retain copies of the form to document:

- o The basis for granting exemptions to claimants;
- o The extent of verification performed on the claimant's representations; and
- o Who reviewed and approved the exemption.  
(Priority 2)

Recommendation #12:

Require the utility companies to submit customer exemption lists to the City at least quarterly, including any partial lists available from the telephone companies. Finance should review these lists to ensure that all customers are eligible for the tax exemption. (Priority 2)

RECEIVED

MAR 11 1987

CITY OF SAN JOSE - MEMORANDUM

CITY AUDITOR

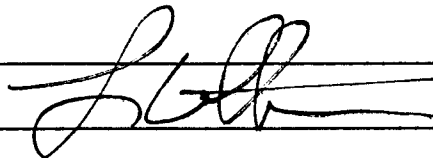
TO: Honorable Mayor and City Council

FROM: Edward G. Schilling  
Director of Finance

SUBJECT: Response to Auditor's Utility  
Tax Audit

DATE: March 11, 1987

APPROVED



DATE

Finance has reviewed the City Auditor's draft report dated February 25, 1987, which replaces the previously transmitted drafts of February 11, 1987 and January 30, 1987. Finance basically concurs with the recommendations. In particular, Finance intends to take immediate steps to require collection-based remittance, enforce timely payment and strengthen the exemption approval process. However, Finance does not concur with certain portions of the findings. For example, while the City Auditor estimates a potential revenue loss of \$300,000 during 1985-86, Finance staff's calculations indicate that the estimated potential loss would not be likely to exceed \$72,526 and could actually be as low as \$35,585.\*

Since Finance and the City Auditor have not been able to agree on performance criteria and estimated loss calculations, Finance is responding to each major finding as well as to the attendant recommendations. In addition, Finance believes that the assigned audit recommendation priority codes overstate the urgency of recommended changes and do not recognize the time and effort which will be required for their implementation.

Finance is also responding to the City Auditor's March 2, 1987 memorandum which added two recommendations. This response can be found at the conclusion of this letter.

Finally, it must be noted that, while Finance intends to tighten requirements for collection and remittance of the City's utility users tax, any revisions to the utility users tax ordinance will require review and input by the utility companies.

FINDING NO. I: Finance needs to improve its monitoring of utility tax receipts to ensure collection of late payment charges.

RESPONSE TO FINDING:

Summary

The City Auditor estimates that \$64,800 in penalty and interest charges should have been collected during the audited period. Finance staff calculations

\* This calculation uses Finance estimates of revenue lost and potentially recoverable due to late payment of utility taxes, untimely billing of newly annexed properties, and unpursued delinquent tax accounts. It also assumes no recovery from bankruptcies, invalid adjustments and questionable exemptions.



indicate that only \$241 in interest and \$2,958 in penalties on late payments could reasonably have been applied during the period covered by the audit. The difference in calculations results from the fact that Treasury accepts as prompt those payments postmarked on or before the due date while the Auditor has based his calculations on the assumption that revenue should be received and posted by the due date. A preliminary survey of other government agencies indicates that acceptance of a postmark is common. While Finance agrees that actual receipt of payment on or before the due date is a preferred cash management practice, application of this theoretical concept may not be practical. Finance will review the situation further to determine appropriate action. Even if this policy is changed, however, Treasury will continue to pick up the PG&E remittance, which exceeds \$1 million per month, until the utility company is willing to wire the payment to the City's bank.

### Discussion

Finance, Treasury, has traditionally accepted as timely all payments received or postmarked on or before the due date. This practice is necessary due to: 1) processing volume, which prohibits date stamping receipts and 2) the uncertainty of mail delivery, which often generates disputes over date of receipt. These procedures have been in effect for at least ten years and were therefore always subject to review under the City Auditor's continuing annual Cash and Revenue Audits.

Treasury staff does, in fact, examine envelopes for postmark date and retains envelopes to substantiate late payments. However, timely postmarked envelopes are not retained. Since Treasury processes a large volume of transactions each year, the retention of all envelopes is not practical.

The U.S. Mail is delivered to the City Mail Room where it is sorted and made available for pickup by City departments. Mail is received through this system up to six days after the postmark date, particularly if delivery follows a weekend. Staff analysis indicated that if a six-day grace period were allowed to encompass that mail processing period, only a few small utility company payments were actually overdue. The Finance estimate of a potential recovery of \$3,199 is based upon application of this grace period to the actual date when payment was posted in Treasury records. In those circumstances where a large utility company payment was received more than three days after the due date, staff observed that mail delivery followed a weekend.

Finance will review the situation with the utility companies and will research practices in other cities prior to a final decision regarding requirement of actual receipt on the due date. Penalties and interest will be strictly applied to payments not meeting the established deadline.

It is Treasury practice to obtain major revenues by bank wire whenever possible. Treasury has unsuccessfully attempted to obtain agreement from the large utility companies to wire payments to the City's bank. Since the PG&E monthly remittance exceeds \$1 million, it is cost-effective to continue pickup by a Treasury investigator. Treasury is exploring the expansion of this practice to cover other large remittances.

RESPONSE TO RECOMMENDATIONS:Recommendation No. 1:

Recommend to the City Council that the Municipal Code be amended to 1) specify that the City is to receive utility tax payments by the end of the month or June 25 in the case of May collections, and 2) automatically impose penalties on late payments. (Priority 1)

Response:

Treasury is working with the City Attorney's Office to prepare an ordinance to amend the Code to provide automatic imposition of penalty and interest upon late payment. The old language requiring receipt of May collections on or before June 25 will be stricken from the ordinance because it is based on an outdated Accounting procedure. Finance will determine whether or not to continue accepting as timely payments postmarked on or before the due date. Any necessary Code revisions will be prepared accordingly.

Recommendation No. 2:

Advise all the utility companies of the Municipal Code penalty and interest provisions with respect to late payments and inform them of the City's intention to apply the penalty and interest charges accordingly. (Priority 1)

Response:

Each utility company will be given an opportunity to review a draft of the proposed ordinance and will receive a copy of any ordinance enacted by Council with an appropriate cover letter.

FINDING NO. II: Delays in 1) Finance notifying the utility companies of annexations, and 2) the utility companies applying the tax on newly annexed property should be eliminated.

RESPONSE TO FINDING:Summary

The City Auditor estimates \$112,300 lost revenue due to untimely billing of annexed property. However, Finance staff calculations indicate an estimated maximum potential loss of \$30,483 for untimely annexation billings, if utility companies are allowed 90 days to add new accounts to their billing systems from the date of annexation. Treasury investigates annexations as soon as maps are received from the Planning Department and reinvestigates if more than thirty days elapse prior to official annexation. Street Index updates and utility company notification letters are prepared in an average turnaround time of 18 days from receipt of City Clerk notification. Some utility companies are currently expressing a need for at least ninety days to add annexations to their billings. Treasury estimates that from 90 to 120 days in total is a reasonable processing period from annexation to billing. This allows 10 days for notification (State to City Clerk, City Clerk to Treasury), 20 days for Treasury processing and 60 days for utility company processing.

Discussion

Treasury receives the Planning Department's maps of annexation areas from one week to two years prior to official annexation. Field investigations and temporary map markings are completed upon receipt of these maps. If more than thirty days elapse after preparation of the temporary maps, annexation areas are reinvestigated upon notification of official annexation by the City Clerk. Final maps and street index updates are then prepared.

During the period covered by the audit, Treasury staff maintained an average turnaround time of 18 days from receipt of City Clerk notification to update of the Street Index and preparation of the notification letter. This period of time included an unusual volume of transactions stemming from the MORGA annexations. Of the 81 annexations (3,910 addresses) during the period audited, 52 (3,299 addresses) were the MORGA packaged annexations of County pockets. Treasury believes that a 20 day turnaround is reasonable, and will strive to improve on that standard whenever possible.

In revising the Code provisions, Finance will work with the utility companies to determine a reasonable billing turnaround time. Finance estimates that this may be sixty to ninety days after receipt of notification. Thus, the combined turnaround time of LAFCO and City Clerk notification, Treasury processing, mail processing and utility company processing may range from 90 to 120 days.

The City Auditor's estimate of lost taxes due to late billing of annexed properties assumed that all newly annexed properties must begin being taxed by the utility companies on the date the annexation becomes effective. The auditor's sample is small compared to the population reviewed and does not appear to give special consideration to significant special conditions. The period covered by the audit included the MORGA annexations which account for 64% of the annexations and 84% of the new billing addresses for the period. The MORGA annexations were packaged and, thus, were transmitted simultaneously to the utility companies, presenting them with an unusual volume of billing updates.

The Auditor used a questionnaire to survey three utility companies on their handling of 5 addresses out of each of three annexations. Following is a description of the population size and its relationship to the sample:

	<u>MORGA</u>	<u>ALL OTHERS</u>
# Companies - Population	20	20
# Companies - Sample	3	3
# Annexations - Population	52	29
# Annexations - Sample	2	1
# Addresses - Population	3299	611
# Addresses - Sample	10	5

Finance staff calculated the average days delay in billings comparing the Auditor's standard (zero days from official annexation to utility company billing of tax) to a tentative Finance standard, (90 days from annexation to billing) as follows:

<u>NUMBER OF DAYS DELAY</u>				
	<u>ZERO DAYS PROCESSING</u>		<u>90 DAYS PROCESSING</u>	
	<u>MORGA</u>	<u>ALL OTHER</u>	<u>MORGA</u>	<u>ALL OTHER</u>
Number of Days, Each Address:				
	0*	40	0	0
	0*	40	0	0
	0*	40	0	0
	40	40	0	0
	40	74	0	0
	40	74	0	0
	40	74	0	0
	40	74	0	0
	42	74	0	0
	42	79	0	0
	42	102	0	12
	42	110	0	20
	55	110	0	20
	55	140	0	50
	55	261	0	171
	55		0	
	55		0	
	114		24	
	114		24	
	114		24	
	144		54	
	236		146	
	236		146	
	236		146	
	236		146	
	236		146	
	337		247	
	337		247	
	337		247	
	337		247	
Sample mean (average):	121.9	88.8	61.5	18.2
Sample median** (midpoint):	55	74	0	0

\* One address was on tax billing prior to annexation

\*\* The median was calculated only to help assess the reliability of the mean as a measure of central tendency. The wide disparity between the two (121.9 vs. 55) shows that the sample data is not normally distributed and must be viewed skeptically in drawing conclusions about the entire population.

Finance staff averaged the Auditor's estimated daily tax rate for each of the three utility companies and obtained an overall daily tax rate per address of: 5¢ for MORGA Annexations; and 7¢ for all other annexations. Staff then recalculated estimated loss using the mean only as estimated days billing delay per address. The calculation used is: days delay x number of addresses x daily rate x number of utility companies. For example:  $121.9 \times 3299 \times .05 \times 3 = \$60,322$ , estimated revenue loss for MORGA annexations allowing zero days processing. Following are the results of this analysis:

	<u>Estimated Revenue Loss</u>		
	<u>MORGA</u>	<u>ALL OTHER</u>	<u>TOTAL</u>
Zero Days Processing:	\$60,322	\$11,401	\$71,723
90 Days Processing:	\$30,483	\$0	\$30,483

Thus, depending on the number of days allowed to implement the tax billings, estimated revenue loss ranges from \$30,483 to \$71,723.

The City Manager's office has established a committee, chaired by the Department of Neighborhood Preservation, to assess needs and implement a comprehensive, automated address file (Situs Project). This committee, which began meeting in December 1986, will address requirements for establishing and maintaining the City's Situs File.

#### RESPONSE TO RECOMMENDATIONS:

##### Recommendation No. 3:

Define the responsibilities and time standards involved in preparing the San Jose Street Index revisions and correction letters, formally assign the responsibilities to the proper department, and provide the required resources to ensure that the responsibilities are carried out effectively and efficiently. (Priority 1)

##### Response:

The City Managers Office will determine the requirements for establishing and maintaining an updated address file (Situs Project).

##### Recommendation No. 4:

Recommend to the City Council that the Utility Users Tax Ordinance be amended to specify how many days after City notification of annexations the utility companies have to apply utility taxes on customer billings. (Priority 1)

##### Response:

Finance concurs and is working with the City Attorney's Office to develop an ordinance amendment. The establishment of time standards for billing newly annexed properties will require review and comment by the affected companies

Recommendation No. 5:

Establish a monitoring procedure to ensure that the utility tax on newly annexed addresses are promptly included on the customer's utility bills.  
(Priority 1)

Response:

Finance concurs and will establish reporting procedures for utility companies.

FINDING NO. III: Finance should improve its monitoring of the delinquent tax collection processes.

RESPONSE TO FINDING:Summary

The City Auditor estimates potential revenue loss of \$15,900 in invalid adjustments and \$100,988 in delinquent taxes. Finance staff calculations indicate the possible recovery of approximately \$1,860 if collections were pursued on the delinquent tax amounts over \$20. The pursuit of tax amounts under \$20 from persons who have not paid their utility bills is unlikely to produce any significant revenue. Treasury believes that the practice of billing-based remittance, established by the 1970 Finance Regulations, has resulted in administrative difficulties. Accordingly, these Regulations will be immediately rescinded, allowing a reasonable time for utility companies to convert from billing-based to collection-based remittance systems. Treasury points out that pursuit of the relatively lesser sum of \$358 in refusals to pay tax is readily explained as an appropriate Code enforcement practice.

Discussion

Treasury has requested additional information from PG&E concerning the estimated \$15,900 in invalid adjustments. The complexity of the billing-based remittance procedures and staffing limitations have impeded proper monitoring of remittances by the utility companies. Treasury intends to take immediate steps to require collection-based remittances by notifying utility companies that the 1970 Regulations are repealed and giving the companies a reasonable time period to convert their billing-based systems to a collection basis.

Concurrent with requiring collection-based remittance, Treasury will increase requirements for utility companies' tax collection efforts. While final language depends on review by the City Attorney and utility company input, Treasury intends to require utility companies to pursue tax collection for as long as and in the same manner as they pursue their delinquent service charges.

Of the estimated \$88,404 in unpursued delinquent tax amounts cited in the audit, only approximately \$28,613 would normally be pursued in a collection process. This is because delinquent amounts of \$5 or less are routinely dismissed and the pursuit of amounts less than \$20 is not cost-effective. If a very optimistic collection rate of ten percent is applied to those accounts of \$20 and more, only \$2,861 is likely to be recovered. Deducting a standard collection agency fee, generally 35% of collections, further reduces the potentially recoverable amount to \$1,860.

Treasury will continue to pursue collection of refusals to pay tax, regardless of amount, since this is a necessary enforcement tool. Treasury also points out that refusals to pay have long-term financial impact if the refusing party continues to receive utility service. Staff assumes that the amount of \$358 cited in the audit represents only the amount of tax on the initial utility bill.

The estimated \$12,584 in write offs consists primarily of bankruptcies. There is no assurance that these funds could be recovered through the legal claim process. In the amended ordinance, utility companies will be required to promptly report to Treasury all bankruptcy proceedings involving uncollected taxes.

RESPONSE TO RECOMMENDATIONS:

Recommendation No. 6:

Amend the City's utility tax remittance regulations to be in consonance with the current Municipal Code and require utility service providers to remit utility taxes on the basis of collections, not billings. (Priority 2 )

Response:

Finance concurs and will require collection-based remittance after notice to the utility companies allowing reasonable time for conversion of billing-based systems to collection-based systems.

FINDING NO. IV: Finance should improve its controls over the utility tax exemption process.

RESPONSE TO FINDING:

Insufficient information precluded staff review of the Auditor's calculations for the estimated \$8,500 in improper exemptions. However, Finance agrees that controls for the exemption process need to be strengthened. Currently, although utility companies are expected to clear exemption requests through Treasury, this procedure is obviously not being followed consistently.

New exemption procedures will be developed and issued to all utility companies. Any necessary Code revisions will be incorporated in the draft ordinance. Treasury is working closely with the City Attorney's office to insure that appropriate procedures and Code revisions are developed. Utility companies will be afforded an opportunity for comment.

Recommendation No. 7:

Update the utility users tax regulations adopted in August, 1970, and provide all utility companies with copies, including excerpts, of San Jose Municipal Code Chapter 4.68 (the Utility Tax Ordinance). (Priority 1)

Response:

Finance is working with the City Attorney's office to develop an ordinance amendment addressing, among other things, the exemption process. More explicit requirements in the ordinance will eliminate the need for Finance Department issued regulations at this time.

Recommendation No. 8:

In conjunction with the utility companies, develop and document a tax exemption process to ensure City control over eligibility determination and the efficient and timely processing of tax exemption applications. (Priority 1)

Response:

Finance concurs and is working with the City Attorney's office to achieve implementation.

Recommendation No. 9

Develop a tax exemption application form for those utility users requesting exemption from the utility users tax. Finance should use and retain copies of the form to document:

- o The basis for granting exemptions to claimants;
- o The extent of verification performed on the claimant's representations; and
- o Who reviewed and approved the exemption.  
(Priority 2)

Response:

Finance concurs and is working with the City Attorney's office to achieve implementation.

Recommendation No. 10:

Require the utility companies to submit customer exemption lists to the City at least quarterly, including any partial lists available from the telephone companies. Finance should review these lists to ensure that all customers are eligible for the tax exemption. (Priority 2)

Response:

Finance concurs and is working with the City Attorney's office to achieve implementation.



RESPONSE TO MARCH 2 RECOMMENDATIONS:

Recommendation No. 7:

Initiate the collection of City Auditor identified invalid or overstated tax adjustments. In addition, Finance should 1) require utility companies to provide sufficiently detailed tax adjustment reports to allow for subsequent review, and 2) review on a sample basis reported tax adjustments for propriety. (Priority 1)

Response:

Finance is reviewing the cited invalid adjustments and will investigate the feasibility of pursuing the cited delinquent tax amounts within the bounds of cost-effective collection techniques. For the future, Finance will increase collection requirements for utility companies and strengthen monitoring procedures.

Recommendation No. 8:

Initiate the collection of those tax accounts the utilities turned over to the City as provided for in Section 4.68.150(B). (Priority 1)

Response:

Finance will increase requirements for utility company collection efforts and will pursue collection of unpaid amounts turned over to the City within the bounds of reasonable collection practice.

Sincerely,



Edward G. Schilling  
Director of Finance

0136F/0503F

OFFICE OF THE CITY AUDITOR  
COMMENTS ON THE ADMINISTRATION'S  
RESPONSE TO AUDITOR'S UTILITY TAX AUDIT

The following comments are presented to expand upon, clarify and correct several statements in the Administration's "*Response to Auditor's Utility Tax Audit.*" While it is not the normal practice of this Office to include in our reports formal comments on Administration responses, we believe such comments are appropriate in this case given the content of the Administration's response.

*Administration Response - Page 1, First Paragraph*

*Finance has reviewed the City Auditor's draft report dated February 25, 1987, which replaces the previously transmitted drafts of February 11, 1987 and January 30, 1987.*

*Auditor's Comment*

The three drafts noted above are the result of several meetings between the Auditor's Office, the City Attorney's Office and the Administration on the information in the various draft audit reports. In our opinion, the number of draft iterations and the elapsed time of the review process evidences the care the Auditor's Office exercised to present to the City Council a report that was factually correct and fair.

Administration Response - Page 1, First Paragraph

*"For example, while the City Auditor estimates a potential revenue loss of \$300,000 during 1985-86, Finance staff's calculations indicate that the estimated potential loss would not be likely to exceed \$72,526 and could actually be as low as \$35,585.\*"*

*\*This calculation uses Finance estimates of revenue lost and potentially recoverable due to late payment of utility taxes, untimely billing of newly annexed properties, and unpursued delinquent tax accounts. It also assumes no recovery from bankruptcies, invalid adjustments and questionable exemptions.*

Auditor's Comment

The audit report states "... As a result, we estimate that the City potentially lost approximately \$300,000 during 1985-86\* ...\* of the \$300,000 in potential losses, \$112,300 was for the period February 1985 through May 1986." The above \$300,000 is comprised of the following:

<u>Amount of Potential Loss</u>	<u>Cause of Loss</u>
\$ 64,800	Possible late charges and penalties not imposed
112,300	Compounded delays in charging utility taxes on new annexations
15,900	Invalid tax adjustments
100,988	Delinquent taxes the Administration did not attempt to collect
<u>8,500</u>	Improper granting of utility tax exemptions
<u>\$302,488</u>	

The audit report elaborates on each of the above potential losses and clearly indicates that 1) in some instances the estimated loss is based upon certain assumptions and 2) as those assumptions change so would the estimated loss. Further, it is important to keep in mind that the essential point of the audit report is not the exact amount of revenue loss to the City but the administrative and managerial deficiencies that allowed losses to occur regardless of the amount. The Administration may argue theory and methodology but the fact remains that the City did lose revenue and the Administration was unaware of it at the time.

Administration Response - Page 1, Second Paragraph

*Since Finance and the City Auditor have not been able to agree on performance criteria and estimated loss calculations, Finance is responding to each major finding as well as to the attendant recommendations.*

Auditor's Comment

The text of the audit report presents the Administration's version for every one of the issues upon which the Auditor's Office and the Administration could not agree. This was done in the interest of full disclosure of all the facts and reflects a good faith effort on the part of the Auditor's Office to be fair to the Administration.

Administration Response - Page 1, Second Paragraph

*In addition, Finance believes that the assigned audit recommendation priority codes overstate the urgency of recommended changes and do not recognize the time and effort which will be required for their implementation.*

Auditor's Comment

The City Auditor's assigned priority codes are in accordance with the City's Administrative Manual, Section Number 196 which states in part:

*"...The classification scheme applicable to audit recommendations and the appropriate corrective actions are as follows:*

<u>CLASS</u>	<u>DESCRIPTION</u>	<u>IMPLEMENTATION CATEGORY</u>	<u>IMPLEMENTATION ACTION</u>
1	Fraud or serious violations are being committed; <u>significant fiscal</u> or equivalent non-fiscal losses are occurring.	Priority	Mandatory and immediate
2	A potential for incurring significant fiscal or equivalent non-fiscal losses exists.	Priority	Mandatory, within 60 days
3	Operation or Administrative process will be improved.	General	Discretionary

... Significant - for an audit recommendation to be considered related to a significant fiscal loss, it will usually be necessary for an actual loss of \$5,000 or more to be involved or for a potential loss (including unrealized revenue increases) of \$10,000 to be involved.

.. A recommendation which clearly fits the description for more than one class shall be placed in the highest class. The implementation time schedule indicated above for each class is intended as a guideline for establishing implementation target dates. While classifying recommendations is the responsibility of the City Auditor, determining implementation target dates is the responsibility of the City Administration." (Emphasis added)

The above City Administrative Manual Citations clearly 1) require the assigned priority codes as shown in the audit report, and 2) provide the Administration the discretion to establish its own implementation schedule.

Administration Response - Page 2, Second Paragraph

*Finance, Treasury, has traditionally accepted as timely all payments received or postmarked on or before the due date.*

Auditor's Comment

Finance has never documented its policy regarding payment timeliness in any sort of manual or memorandum. Further, Finance's interpretation of the Municipal Code's payment requirements may not reflect City Council intent. In that eventuality, Finance's postmark date arguments would be superfluous.

Administration Response - Page 2, Third Paragraph

*Treasury staff does, in fact, examine envelopes for postmark date and retains envelopes to substantiate late payments.*

Auditor's Comment

Finance could not produce any envelopes it retained to substantiate late payments. When questioned about obviously late payments that were identified during our audit period, staff responded that the amounts were small and that charging interest or imposing late charges would be too much of a hassle. Therefore, according to Finance staff, there was no need to retain the envelopes. It should be noted that 1) Finance has no official policy statement or instructions on this matter and 2) Code Section 4.68.130(B) requires that service providers pay interest or late remittances regardless of amount.

Administration Response - Page 3, Second Paragraph

*Treasury is working with the City Attorney's Office to prepare an ordinance to amend the Code to provide automatic imposition of penalty and interest upon late payment. The old language requiring receipt of May collections on or before June 25 will be stricken from the ordinance because it is based on an outdated Accounting procedure.*

Auditor's Comment

Removing the June 25 requirement will cost the City about \$3,000 a year in forgone interest earnings.

Administration Response - Page 3, Second Paragraph

*Finance will determine whether or not to continue accepting as timely payments postmarked on or before the due date. Any necessary Code revisions will be prepared accordingly.*

Auditor's Comment

Whether payments should be received or postmarked by the end of the month is a policy decision that the City Council should make, not Finance.

Administration Response - Page 3, Fifth Paragraph

*The City Auditor estimates \$112,300 lost revenue due to untimely billing of annexed property. However, Finance staff calculations indicate an estimated maximum potential loss of \$30,483 for untimely annexation billings, if utility companies are allowed 90 days to add new accounts to their billing systems from the date of annexation.*



Auditor's Comment

On February 18, 1987, the manager of Customer Service for San Jose Water Company wrote a letter to the City Auditor which stated in part:

*"... Delays in applying the utility tax. I suggest that the City Finance Department establish a simple transmittal form to convey changes in the tax status. This form would be signed off by the company after the changes are made and returned to the City Finance Department. By the way, these changes can be made quickly by our company." (Emphasis added)*

Based upon the above communication, at least one of the major utility service providers is able to add new accounts to its billing system quickly. If one major company can add accounts quickly it seems reasonable to expect that the other companies could react quickly as well. Therefore, while some implementation grace period may be reasonable, 90 days appears to be entirely too generous.

Administration Response - Page 3, Fifth Paragraph

*Treasury estimates that from 90 to 120 days in total is a reasonable processing period from annexation to billing. This allows 10 days for notification (State to City Clerk, City Clerk to Treasury), 20 days for Treasury processing ...*

The audit report states in part:

*"... Further, our review of the annexation process revealed that the Planning Department sends Finance copies of boundary maps for property to be annexed as much as 12 weeks before Finance is currently starting its inspection process. Further, the City Council approves annexations two to three weeks before they are effective. Thus, in our opinion, Finance should be able to have its inspection process either completed or substantially completed by the time annexations are effective ..."*

During our audit period Finance's average turnaround time for annexations was 18 days. Finance now believes a 20 day turnaround time is reasonable. In our opinion, such a conclusion is not logical in view of the fact that improved coordination between Finance and the Planning Department should reduce Finance's turnaround time for annexations, not increase it.

Administration's Response - Page 6, First Paragraph

*The calculation used is: days delay x number of addresses x daily rate x number of utility companies. For example:  $121.9 \times 3299 \times .05 \times 3 = \$60,322$ , estimated revenue loss for MORGA annexations allowing zero days processing. (Emphasis added)*

Auditor's Comment

The example should be  $121.9 \times 3299 \times .04 \times 4$  (not 3) = \$80,430 (not \$60,322). Finance neglected to include a provision for utility taxes from AT&T Communications in its calculation.

Administration Response - Page 7, Third Paragraph

*Finance staff calculations indicate the possible recovery of approximately \$1,860 if collections were pursued on the delinquent tax amounts over \$20. The pursuit of tax amounts under \$20 from persons who have not paid their utility bills is unlikely to produce any significant revenue.*

Administration Response - Page 7, Sixth Paragraph

*Of the estimated \$88,404 in unpursued delinquent tax amounts cited in the audit, only approximately \$28,613 would normally be pursued in a collection process. This is because delinquent amounts of \$5 or less are routinely dismissed and the pursuit of amounts less than \$20 is not cost-effective.*

Administration Response - Page 10, Fourth Paragraph

*Finance will increase requirements for utility company collection efforts and will pursue collection of unpaid amounts turned over to the City within the bounds of reasonable collection practice.*

Auditor's Comment

The Administration continues to ignore the fact that the Director of Finance is required by Municipal Code Section 4.68.150(B) to attempt to collect all delinquent tax accounts regardless of amount. If the Administration feels that the Code is too onerous or impractical, then it

should propose that the City Council amend it. However, until such time as the Code is amended, the Director has no choice but to comply with the current requirement to pursue all delinquent tax accounts. Further, the Administration's response does not take the following into account:

- o The minimum \$10 penalty fee provision in Municipal Code Section 4.68.150(B) could increase the amount of delinquent accounts shown in the audit report by \$119,340 to a total of \$207,744.
- o The delinquent accounts shown in the audit report are for PG&E customers only. Other service providers do not provide the Administration with the names and amounts of any delinquent accounts. As a result, the total dollar value of delinquent tax accounts the Administration did not pursue collection of during our audit period is undoubtedly larger than the figure shown in the audit report.

Administration Response - Page 7, Sixth Paragraph

*If a very optimistic collection rate of ten percent is applied to those accounts of \$20 and more, only \$2,861 is likely to be recovered.*

Auditor's Comment

A ten percent collection rate is not very optimistic. In fact, it is very pessimistic. According to PG&E it collects its service charges on about 25 percent of those accounts it turns over to the City for collection. Further, a Bay Area Collection agency stated it collects on about 30 percent of its accounts over \$20.

Administration Response - Page 8, First Paragraph

*Treasury will continue to pursue collection of refusals to pay tax, regardless of amount, since this is a necessary enforcement tool. Treasury also points out that refusals to pay have long-term financial impact if the refusing party continues to receive utility service. Staff assumes that the amount of \$358 cited in the audit represents only the amount of tax on the initial utility bill.*

Auditor's Comment

Staff's assumption is incorrect. In October 1970, the California Public Utilities Commission ruled that a utility cannot enforce the collection of taxes on utility customers by cutting off their service. Thus, the \$358 is a cumulative figure and represents the results of successive refusals to pay the tax over a one year period.

APPENDIX A  
SUMMARY OF CALCULATED  
INTEREST AND PENALTIES ON  
LATE PAYMENTS DURING 1985-86  
-----

Utility Supplier -----	Amount of Remittance -----	Number of Days Received After Due Date -----	Calculated Interest -----	Calculated Penalty -----
P G & E	\$1,582,307.83	2	\$7,911.54	
	1,983,159.44	3	9,915.80	
	1,926,339.43	3	9,631.70	
	1,673,561.44	1	8,367.81	
	1,536,721.78	2	7,683.61	
	1,556,074.20	5	7,780.37	
	-----		-----	
	\$10,258,164.12		\$51,290.82	
	-----		-----	
PACIFIC	\$501,989.97	4	\$2,509.95	
BELL	515,697.23	5	2,578.49	
	-----		-----	
	\$1,017,687.20		\$5,088.44	
	-----		-----	
AT&T COM-	\$154,603.02	4	\$773.02	
MUNICATIONS	143,192.50	2	715.96	
	131,131.03	3	655.66	
	122,277.00	3	611.39	
	130,099.63	5	650.50	
	170,456.04	2	852.28	
	140,316.07	6	701.58	
	-----		-----	
	\$992,075.29		\$4,960.38	
	-----		-----	
U.S. TELE-	\$2,150.27	5	\$10.75	
PHONE OF	-----		-----	
THE WEST				
SATELLITE	\$2,624.50	3	\$13.12	
BUSINESS	4,668.39	4	23.34	
SYSTEMS	4,072.69	4	20.36	
	-----		-----	
	\$11,365.58		\$56.83	
	-----		-----	

## APPENDIX A

Utility Supplier -----	Amount of Remittance -----	Number of Days Received After Due Date -----	Calculated Interest -----	Calculated Penalty -----
BIZTEL, LTD.	\$3,712.04	21	\$18.56	\$371.20
	2,317.62	13	11.59	231.76
	2,678.25	22	13.39	267.82
	3,380.38	32	33.80	338.04
	2,599.87	37	26.00	259.99
	2,815.05	28	14.08	281.50
	2,886.54	46	28.87	288.65
	4,076.23	52	40.76	407.62
	-----		-----	-----
	\$24,465.98		\$187.05	\$2,446.58
	-----		-----	-----
TELESPHERE NETWORK	\$3,850.53	2	\$19.25	
	3,192.78	2	15.96	
	2,382.83	6	11.91	
	2,231.55	6	11.16	
	2,644.54	18	13.22	\$264.45
	2,183.67	11	10.92	218.37
	2,308.76	6	11.54	
	2,304.64	3	11.52	
	2,002.99	8	10.01	
	-----		-----	-----
	\$23,102.29		\$115.51	\$482.82
	-----		-----	-----
REPUBLIC TELCOM	\$2,476.06	1	\$12.38	
	1,933.67	4	9.67	
	-----		-----	
	\$4,409.73		\$22.05	
	-----		-----	
WESTERN UNION	\$605.09	5	\$3.03	
	-----		-----	
ALLNET COMM. SERVICES	\$880.73	1	\$4.40	
	670.75	4	3.35	
	1,051.09	3	5.26	
	863.94	4	4.32	
	909.75	2	4.55	
	768.37	6	3.84	
	875.69	5	4.38	
	1,237.02	4	6.19	
	1,778.16	6	8.89	
	-----		-----	
	\$9,035.50		\$45.18	
	-----		-----	

# APPENDIX A

Utility Supplier -----	Amount of Remittance -----	Number of Days Received After Due Date -----	Calculated Interest -----	Calculated Penalty -----
AMERICAN NETWORK	\$525.62	1	\$2.63	
	384.93	5	1.92	
	433.21	3	2.17	
	1,089.32	9	5.45	
	685.22	6	3.43	
	728.99	5	3.64	
	685.30	4	3.43	
	653.73	4	3.27	
	615.30	8	3.08	
	66.07	3	0.33	
	907.81	8	4.54	
	-----		-----	
	\$6,775.50		\$33.88	
	-----		-----	
GREAT OAKS WATER CO.	\$13,317.95	1	\$66.59	
	-----		-----	
OAKRIDGE WATER CO.	\$73.87	44	\$0.74	\$7.39 *
	114.93	13	0.57	11.49 *
	130.83	64	1.96 *	13.08 *
	40.94	33	0.41 *	4.09 *
	125.08	3	0.63	
	210.48	101	4.21	21.05
	79.98	70	1.20	8.00
	23	82	0.35 *	2.30 *
	60.76	51	0.61 *	6.08 *
	82.12	21	0.41 *	8.21 *
	-----		-----	-----
	\$941.99		\$7.35	\$29.05
	-----		-----	-----
TOTAL	\$12,364,096.49		\$61,887.84	\$2,958.45
	=====		=====	=====

\* The utility supplier self-imposed these interest and penalty amounts. These amounts are not included in our total calculated interest and penalties.



## TAX RETURN - UTILITY USERS TAX

Service Supplier:  
PACIFIC GAS AND ELECTRIC COMPANYTax Period - Calendar Month  
January, 1986

## A. Remittance Based on Collections:

- |   |  |    |
|---|--|----|
| 1 | Gross Collections (Excluding Tax)                    | \$ |
| 2 | Gross Collections from Exempt Accounts               |    |
| 3 | Other Non-Taxed Collections (e.g., Interstate Tolls) |    |
| 4 | Taxable Collections                                  |    |
| 5 | Tax Due - 5% of Line 4.                              |    |
| 6 | Adjustments* (Plus or Minus)                         |    |
| 7 | Penalty, If Due                                      |    |
| 8 | Interest, If Due                                     |    |
| 9 | Total Tax (Sum of Lines 5, 6, 7, & 8)                | \$ |

## B. Remittance Based on Billings:

- |   |  |                  |
|---|--|------------------|
| 1 | Gross Utility Charges (Excluding Tax)            | \$ 43,716,618.92 |
| 2 | Gross Charges to Exempt Accounts                 | (3,308,302.92)   |
| 3 | Other Non-Taxed Charges (e.g., Interstate Tolls) |                  |
| 4 | Taxable Charges                                  | 40,408,316.00    |
| 5 | Tax Due - 5% of Line 4.                          | 2,020,415.80     |
| 6 | Adjustments* (Plus or Minus)                     | (94,076.37)      |
| 7 | Penalty, If Due                                  |                  |
| 8 | Interest, If Due                                 |                  |
| 9 | Total Tax (Sum of Lines 5, 6, 7, & 8)            | \$ 1,926,339.43  |

I declare under penalty of perjury, that to the best of my knowledge and belief, the statements herein and on attachments are true, correct and complete.

Date: February 21, 1986

SECTION SUPERVISOR  
Title: CUST. ACCT. DEPT.

\*Itemize and Explain on Attachments

A-1 B-1

Pacific Gas and Electric Company

User's Tax  
City of San Jose

	Electric	Gas	Combined Total
Total Revenue	28,826,762.59	14,889,856.33	43,716,618.92
Less Exempt Revenue	(2,181,496.79)	(1,126,806.13)	(3,308,302.92)
Net Taxable Revenue	26,645,265.80	13,763,050.20	40,408,316.00
Tax @ 5%	1,332,263.29	688,152.51	2,020,415.80
Plus or Minus Tax Adjustment Only	(58,101.06)	(30,010.88)	(88,111.94)
Less Customers Refusals to Pay	(18.11)	(9.35)	(27.46)
Less Tax on Accounts Submitted to Collection Agencies	(3,683.15)	(1,902.45)	(5,585.60)
Less Tax on Accounts Written Off	(231.69)	(119.68)	(351.37)
Net Tax Payable	\$ 1,270,229.28	\$ 656,110.15	\$ 1,926,339.43

001-030150-01

001-030150-02

3/3/86